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W. C. Skiff
J. R.

DECISION

THE COMPTROLLER GENERAL
OF THE UNITED STATES
WASHINGTON, D. C. 20548

FILE: B-201722

DATE: March 24, 1982

MATTER OF: Mid-East Services, Inc.

DIGEST:

Protest against an agency's determination to perform services in-house based on a cost comparison with solicited offers is sustained because the agency failed to follow prescribed guidelines in conducting the comparison. The agency's estimate of in-house costs did not include the annual depreciation of tangible capital assets as required by the guidelines.

Mid-East Services, Inc. protests the Air Force's determination that the Air Force could perform refuse collection and disposal services at MacDill Air Force Base at a lower cost than Mid-East based on a comparison of Mid-East's low bid (under solicitation No. F08602-80-B-0079) with cost estimates prepared by the Air Force. Mid-East alleges that the Air Force incorrectly implemented the regulations, policies, and procedures referenced in the solicitation as the ground rules for the cost comparison. We sustain the protest.

The decision whether to perform work in-house or by contract involves a matter of Executive branch policy which we generally do not review under our bid protest function. When an agency, however, utilizes the procurement system to aid its decision, spelling out the circumstances under which a contract will or will not be awarded, we will review an allegation that the agency did not comply with the established ground rules. See Serv-Air, Inc., AVCO, 60 Comp. Gen. 44 (1980), 80-2 CPD 317. We believe it would be detrimental to the system if after the agency induces the submission of offers, there is a faulty or misleading cost comparison which materially affects the decision. Serv-Air, Inc.; AVCO, supra.

In this case the ground rules were set forth in the solicitation's cover sheet (among other places), which advised bidders that the acquisition would be subject to a cost comparison between the cost of in-house performance and the cost of contracting, and that the comparison would be accomplished according to the procedures in Air Force Regulation (AFR) 26-1 (Draft) and the Office of Management and Budget Circular No. A-76 Handbook.

In addition, the solicitation contained a "NOTICE OF COST COMPARISON" clause, which stated in part:

"The Government's in-house cost estimate shall be based on the statement of work set forth in this solicitation and shall be submitted to the Contracting Officer in a sealed envelope not later than the time set for bid opening. At the time of the bid opening, the bids and the sealed Government in-house estimate will be opened and the results announced. This announcement is based upon an initial comparison of the cost of in-house performance with the cost of contracting out as indicated on the cost comparison form. The abstract of bids, the completed cost comparison form and detailed supporting data relative to the in-house cost estimate shall be made available to interested parties for review."

The clause also provided that, prior to the determination to award a contract or to perform the services in-house, interested parties would be given ten working days to review the cost comparison data, during which time any interested party could file a written request with the contracting officer for review of the cost comparison results. After resolving any requests for review and evaluating bids, the contracting officer was to announce the results of the cost comparison and make the completed cost comparison analysis available to all interested parties. AFR 26-1 (Draft) also requires that the documentation for the cost comparison be released to interested parties.

Before proceeding to consider the protester's substantive allegation that the cost comparison was faulty, we note that the Air Force failed to adhere to the disclosure procedures detailed in the "NOTICE OF COST COMPARISON" clause. The contracting officer never notified bidders when the ten-working-day review period commenced, observed its passing in silence, and then announced the cancellation of the solicitation because the cost comparison showed in-house performance to be approximately \$68,000 less costly. The Air Force denied Mid-East's subsequent requests for the cost comparison documentation. The Air Force finally did release that information, with the agency report on the protest, more than six months after the protest was filed with this Office. These actions also were in disregard of the A-76 Handbook, which requires the contracting officer to announce the initial results of the cost comparison and then make the cost data available to interested parties and allow them an opportunity to submit their requests for review. Handbook Chapter I, paragraph D(9).*

The Air Force's actions effectively denied the protester an opportunity to have the Air Force's decision reviewed before much of the performance period had progressed. The solicitation provided for a base year plus options for two additional years, and the base term has now expired. By separate letter, we are advising the Secretary of the Air Force of the procedural deficiency, and we are recommending that he take appropriate action to prevent such a problem in the future.

Concerning the validity of the cost comparison itself, the Air Force, in its report on the protest and in subsequent submissions to this Office, identified several errors and revised the cost comparison to show that the cost of in-house performance over the three-year period (base year plus two option years) will be approximately \$25,000

* The requirement for giving offerors express notice of the review period and making available to them the completed cost comparison and detailed supporting data is now explicitly stated in Defense Acquisition Regulation § 4-1203.4(a)(1)(DAC 76-28, July 1981).

less costly than contracting. The protester still raises several objections to the cost comparison. We have thoroughly reviewed the objections, and find nothing materially wrong with the cost comparison in those respects. Nonetheless, our review of the protest discloses one significant shortcoming, not specifically noted by Mid-East, which suffices to change the comparison's results.

The protester alleges that the Air Force failed to evaluate properly certain cost factors pertaining to Air Force equipment used for refuse disposal. Specifically, the protester asserts that the Air Force failed to compute properly the "cost of capital" and "net proceeds from disposal of assets" for equipment which would be used for in-house performance but would not be retained if a contract were awarded. The cost of capital is an imputed cost representing the income that the equipment would provide, or the interest expenses that would be avoided, if the equipment were devoted to other uses. The net proceeds from disposal of assets is the gain or loss which the Government would derive from selling equipment no longer needed in the event of a contract.

To estimate these factors, it is necessary to determine the net book value of the equipment, which is the total acquisition cost less depreciation accumulated prior to the cost comparison period. "Depreciation" is merely the method used to spread the costs of the equipment, less residual value, over the estimated useful life. Basically, cost of capital is reached by applying ten percent to the net book value. The net proceeds from disposal of assets is the difference (whether gain or loss) between the net book value and the current market value, after an adjustment for the expenses of disposing of the equipment.

While the Air Force's computations of the cost of capital and net proceeds from disposal of assets included the net book value of certain assets--two dump trucks and dumpster containers--for the contracting out side of the comparison, it did not include an estimate of further depreciation of the same equipment in the event of in-house performance. Inclusion of this cost factor would increase the Air Force's estimate of in-house performance costs; it would not affect the cost of contracting since the solicitation required the contractor to supply all vehicles and containers and the record shows the Air Force therefore would dispose of the equipment if the services were contracted.

The A-76 Handbook, Chapter III, paragraph D(4)(c), discusses the computation of depreciation and requires that "the annual depreciation related to all the tangible capital assets (* * * machinery, etc.) used by the work center in providing the product/service being estimated will be included in the work center operations overhead cost," ("Operations overhead" is one line item for tallying the costs of in-house performance.) The A-76 Handbook's Glossary defines a "tangible capital asset" as "[a]n asset that has physical substance, more than minimal value, and is expected to be held for continued use * * * beyond the current accounting period." This definition encompasses the equipment in question, since the trucks and containers have been or will be held longer than the contract term, including options.

The A-76 Handbook states that depreciation will be computed on a straight-line basis; that is, an equal amount of the difference between the acquisition cost of the asset and its residual value should be charged to each accounting period or unit of usage covered by its useful life. Handbook, Chapter III, paragraph D(4)(c). Using figures contained in the Air Force's documentation, we find that the annual depreciation of the two trucks alone could be roughly \$8,000 (the record indicates that the acquisition cost of the trucks was more than \$96,000, there is no residual value, and the useful life of the trucks is eight years. The record further indicates that approximately \$72,000 has been written off over the past six years which leaves \$24,000 to be depreciated over the three-year contract period.*) Thus, depreciation of the trucks alone over

* We note that the Air Force attributed only two more years of useful life to the trucks -- the base contract year and one option year -- but also stated that whether two new trucks for the third year could be acquired is a matter of speculation. The Air Force, however, must account for the cost of providing trucks for the third year of performance because the A-76 Handbook states that an asset that is still in use should not be reflected as being fully depreciated and, to avoid such an occurrence, the estimated useful life assets should be reviewed and adjusted periodically to conform to current plans. See Handbook Chapter III, paragraph D(4)(c)(2). For our purpose, we assume that the Air Force will continue to use the trucks it now has throughout the three-year period, and we have made our calculations accordingly.

the three-year contract period would add \$24,000 to the Air Force's three-year estimate of in-house costs, making the in-house cost estimate only \$1,000 less than the contracting cost estimate.

Annual depreciation of the dumpster containers which the Air Force also failed to include would add considerably more to the in-house cost estimate than the \$1,000 cost differential. (The Air Force cost estimate does not provide enough information to determine precisely the annual amount of depreciation of the dumpster. However, the information provided is adequate to demonstrate that the additional depreciation would be at least a few thousand dollars annually.) Thus, when these depreciation costs are included in the comparison, the cost of performance by contract is shown to be less costly than in-house performance.

We are recommending that the Air Force consider awarding the protester a one-year contract with an option for the remaining portion of the performance period that was evaluated originally, assuming Mid-East's bid is responsive and Mid-East is responsible. We make this recommendation for several reasons. The established ground rules for this solicitation clearly indicated that the decision whether to perform in-house or by contract would be based on a cost comparison utilizing the procurement process and performed according to the A-76 Handbook. Since the protester's low bid would have been judged the lowest cost alternative under a proper cost comparison, we believe a decision not to contract out and to make an award to the protester, again assuming that the protester is otherwise eligible for award, would be entirely unfair. Also, although the base period has passed, Mid-East's offers for the option periods, individually and collectively, are less costly than the Air Force's estimated in-house costs adjusted to include depreciation costs. Therefore, assuming that neither the Air Force's needs nor other elements of the cost comparison have changed since the comparison was made, an award to Mid-East would be in the Government's best interest.

If factors have changed significantly so that Mid-East's prices no longer provide the lowest cost alternative to the Air Force, we are recommending that the Air Force consider issuing a new solicitation and conducting a new cost comparison to properly determine whether performance should be in-house or by contract.

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The protest is sustained.

for *Milton J. Fowler*
Comptroller General
of the United States